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Mexico

Sugar

Semi-Annual Report

2005

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Report Highlights:
Sugar production for MY 2005/06 was revised upward to 6.0 million metric tons (MMT) due to good weather conditions. Sugar imports remain unchanged. However, stocks were revised upward to 2.4 MMT as the government has not indicated the strategy that it would follow concerning sugar stocks. Domestic consumption was revised downward due in large part to the increase in the use of fructose (HFCS).

Includes PSD Changes: Yes
Includes Trade Matrix: Yes
Semi-Annual Report
Mexico [MX1]
[MX]

Table of Contents

SECTION I. SITUATION AND OUTLOOK

SUGAR PRODUCTION

The sugar industry in Mexico has indicated that MY 2004/05 (October/September) is a record year for sugar production due to excellent weather conditions that resulted in both good cane and mill yields. As a result, sugar production estimates for MY 2004/05 were revised upward to 6.14 million metric tons (MMT) raw value, an increase of 2.4 percent from the previous estimate and 819,000 tons more than the production figure for the previous year. The domestic industry indicated that for MY 2005/06 sugar production is forecast to reach high production levels again. However, as opposed to the near perfect conditions this year, weather related issues, such as delayed rainfall in one of the main state producers, Veracruz, during the summer of 2005, and excess rainfall at the end of summer could have a negative impact on MY 2005/06 sugar production. Therefore, the forecast for MY 2005/06 is set at approximately 6.0 MMT. Data for MY 2003/04 remains unchanged.

Area planted for MY 2004/05 and 2005/06 remains unchanged, however area harvested was revised upward based on available official information. The sugar cane production for MY 2004/05 and 2005/06 was revised upward based on relatively good weather conditions and expectations of increased cane yields. Area planted and harvested for MY 2003/04 remains unchanged. The average yield of sugar per metric ton of cane is 125 Kg. of sugar.

Sugarcane Prices

According to regulations, approximately 57 percent of a set reference price of standard sugar is paid to growers for their sugarcane. The reference price of standard sugar for MY 2004/05 was established at $5,759.97pesos per MT (US$533.33/MT) resulting in a $3,283.18/MT (US$303.94) price for sugarcane. This formula for determining grower sugarcane prices has been in place since 1993, and although revoked along with the old Sugar Law, it was reenacted within the New Sugar Law published in August 2005 (See Policy Section).

SUGARCANE PRICES	
Marketing Year	Dollars/MT
2001/2002	265.69
2002/2003	232.30
2003/2004	268.81
2004/2005	303.94

HFCS Production

High fructose corn syrup (HFCS) production for CY 2005 is expected to increase from previous forecasts to about 300,000 to 400,000 MT dry basis, due to an increase in use from the soda-bottling companies that hold court injunctions (*Amparos*) allowing the use of domestically produced HFCS without being subject to the 20 percent tax. It is still uncertain how the Mexican government will respond to the WTO resolution that has declared the 20 percent tax illegal. However, the fructose industry will continue to produce HFCS as long as the court injunctions are accepted. (See Policy Section.) Industry sources have indicated that given recent increases due to amparo usage domestic production is near capacity and it is unlikely that increased production capacity will be possible in the short term.

Mexican HFCS production for CY 2004 was estimated at between 130,000 and 140,000 MT dry basis. Those companies manufacturing HFCS in Mexico have indicated that the tax has harmed industry investment and at least one company has sought legal redress in the

Mexican courts. U.S. corn imports for the starch industry, used in the local manufacture of HFCS, have also been adversely affected by the HFCS beverage tax. Mexican production of HFCS is not published by official sources and companies treat it as confidential information. At the end of 2004, representatives of the Chamber for the Sugar and Alcohol Industries, as well as sugar producers and congressmen, rejected any changes related to removing the 20-percent tax on the use of fructose in beverages, and, as a result, it remained in effect.

SUGAR AND HFCS CONSUMPTION

The forecast for sugar consumption for MY 2005/06 as well as the estimate for MY 2004/05 were revised downward compared to previous estimates to 5.25 and 5.20 million MT respectively. The reduction in the estimates is due in large part to the increase in the use of fructose (HFCS), as some soda-bottling companies in Mexico have won court injunctions (*Amparos)* exempting them from the 20-percent tax on beverages using HFCS. These bottling companies have already cancelled some sugar supply contracts as they are going back to consuming HFCS. The Chamber for the Sugar and Alcohol Industries is estimating that some 300,000 MT of sugar will be displaced from the market during MY 2004/05, and it is expected that approximately 300,000 to 400,000 MT of HFCS will be consumed during CY 2005. Sugar consumption for MY 2003/04 remains unchanged.

Sugar use under the “other disappearance” category, which is mainly the Mexican re-export program (PITEX), was revised downward for MY 2004/05 and 2005/06 due to lower-than-expected demand from the industry users. The PITEX program allows sugar to be sold as raw material for further processing to Mexican food manufacturers, who buy the sugar from the Mexican sugar mills at about the world price. The food manufacturers must process the sugar within six months of the date of purchase and then must export the final processed product. Given this process, the GOM classifies the sugar sold under the PITEX program as exports. The PITEX program allows Mexican sugar mills to export while at the same time maintaining some flexibility with regard to domestic sugar supplies. Under PITEX, the industry can avoid the situation that would result from selling raw sugar on the world market and then importing it back, should there be an unexpected domestic shortage. Also, sugar mills and processors avoid transportation expenses. According to the sugar industry, the sugar used under PITEX for MY 2004/05 consisted of about 128,000 MT of imported sugar and 86,000 MT of domestically produced sugar. Sugar under the “other disappearance” category for MY 2003/04 remains unchanged.

Fructose consumption for CY 2005 is expected at approximately 350,000 to 450,000 MT due to an increase in demand from the soda-drink bottlers holding court injunctions. However, HFCS consumption is still constrained by the 20% tax that limits somewhat domestic production and restrictions on imports from the U.S. through the refusal to issue import permits. Consumption for CY 2006 is expected to be similar, if not increase, from CY 2005 consumption if the bottling companies continue demanding this product and the use of amparos continues or increases. However, it is unclear at this point what the government policies will be toward the resolution of the WTO case on the HFCS tax. (See Policy Section).

SUGAR TRADE

Total sugar imports for MY 2005/06 are still estimated at 101,000 MT raw value. It is expected that the government will encourage companies to use domestic sugar through PITEX - instead of importing it - by offering better buying conditions and assurances of quality and on time supply. Due to large sugar stocks forecasted for MY 2005/06, the industry does not expect any imports under a tariff-rate quota (TRQ) as in the past two marketing years. Sugar imports for MY 2004/05 were revised upward from previous estimates to 226,000 MT where approximately 93,000 MT of sugar were imported under a

TRQ that the Mexican government announced to prevent end of year shortages in 2004. (See report MX4128). According to sources about 128,000 MT from this imported sugar was used by the PITEX industries. Sugar imports for MY 2003/04 remain unchanged.

Sugar exports for MY 2005/06 are estimated at 159,000 MT, with approximately 150,000 MT of that sugar being sent to the U.S. under the NAFTA second tier-tariff system. The duty will decline once again in 2006 for raw and refined sugar, as the transition period to duty-free sugar trade in calendar year 2008 continues. The rest of the exports would be the WTO sugar quota that Mexico sends to the U.S. This export level could change depending on what strategy the Mexican government decides to follow concerning the higher sugar stocks (See Stocks Section). Ultimately, this estimate will also be dependent on final sugar production figures; the outcome, if any, of U.S.-Mexico sweetener negotiations; the Mexican response to the WTO decision of the HFCS tax (see Policy Section); and potential substitution by end users to alternative domestic and imported sweeteners. Sugar exports for MY 2004/05 were revised upward to 199, 000 MT. According to the sugar industry, close to 150,000 MT of sugar will be sent to the U.S. under the second tier-tariff system. The estimate for MY 2004/05 includes Mexico's WTO sugar quota to the United States. Sugar exports for MY 2003/04 remain unchanged.

Note: Most of the refined sugar imported into Mexico has been classified by customs into the HTS 1701.99 category, corresponding to " other pure sucrose". It has also been confirmed that U.S. sugar exports for Mexico were classified under the same category.

HFCS TRADE

Due to the continued imposition of the 20-percent duty on HFCS-containing soft drinks and beverages since January 2002, HFCS imports had been down and were not significant until MY 2004/05. Consumption has begun to increase as companies have begun to use *Amparos* exempting them from the 20-percent tax on HFCS. According to trade data, imports of HFCS have suddenly increased for HTS 1702.60 from 5,190 MT in MY 2003/04 to 53,848 MT through May of MY 2004/05. Most of these imports come from Canada and are entering at zero duty. Due to the amparos currently in place, Mexico is expected to continue importing HFCS during CY 2005.

Because of the U.S.-Mexico sweetener dispute, the Secretariat of Economy had not established an HFCS quota nor specified how the import permit system will function. However, the WTO released its panel decision on the beverage tax in August 2005 declaring it discriminatory and illegal. This WTO Report is expected to be made public in September and Mexico will have 60 days to respond to it. According to the Secretariat of Economy and the sugar industry, Mexico could challenge and appeal the WTO decision. If these actions are taken, any final decision on the tax would not be expected to take place until after December 2005. However, the government has also indicated that if Mexico decides not to appeal or loses an appeal, it could select to impose the MFN duty on HFCS imports from the U.S., which is 210 % for HFCS-55, and 156 % for HFCS-42. Further, domestic pressure on the GOM to limit HFCS in whatever manner possible will remain strong, especially given the large production and stocks projected for MY 2005/06.

STOCKS

At the writing of this report the Mexican Government had not indicated the strategy that it would follow concerning the higher sugar stocks that are pressing domestic prices downward and generating storage expenses. Ending stocks for MY 2005/06 were revised upward to 2.4 MMT from previous estimates due to a higher sugar production, however, this stock level could change depending on the Mexican export strategy. On one hand, the government could provide incentives to hold sugar, helping to ensure that there would be enough strategic reserves to meet domestic demand by the end of the year at lower prices than the previous two years. However, some companies could export their stocks to save on storage expenses, guaranteeing they would bring it back if necessary. Another option in place of holding stocks, and that has already been seen, is to sell some sugar to the U.S. under the second-tier tariff system where the returns could be higher (or losses less) than shipping to the rest of the world due to the higher sugar prices in the United States.

It is important to consider that the government policy has been to hold in reserve at least three months of domestic consumption, which would leave an approximate minimum strategic reserve needed for MY 2005/06 of approximately 1.3 MMT. Ending sugar stocks for MY 2004/05 were revised upward from previous estimates due to higher-than-expected sugar production, large enough to ensure that strategic reserves are met. Ending stocks for MY 2002/03 remain unchanged.

POLICY

At this time, on top of high sugar inventories, the Mexican government and the sugar industry face many difficult challenges pertaining to their domestic and international policies toward sugar, highlighted by the approval of the Sugar Law, the outcome from the current WTO case on Mexico's 20 percent duty on HFCS-containing beverages, and the selling of sugar mills that were expropriated by the government.

Although the Fox administration canceled the old sugar legislation (see report MX5005) in an attempt to establish other mechanisms that would make the Mexican sugar sector a more profitable one, other political forces, including the sugarcane associations, successfully worked against this idea. The result was the creation of a new Sugar Law that includes most of the principles of the old sugar legislation used to regulate the sugar sector. This new Sugar Law limits market prices for sugarcane and leaves the payment for sugarcane as it was, regulated by federal decrees. The Fox administration was seeking to deregulate the sector, have a reorganization of the sugar market, and increase competitiveness to face the liberalization of the markets under NAFTA in 2008. However, the Mexican Congress, led by a majority of the opposition party (PRI), approved a new Sugar Law in June to take the place of the old legislation revoked by President Fox. The government and the sugar mill industry did not wholly agree with this decision and unsuccessfully tried to have the law vetoed before it was officially published.

After large demonstrations during the first weeks of August from the sugarcane growers to have the government accept the proposed Sugarcane Law as it was approved in June, the Federal government relented and published the Law almost exactly as adopted by Congress. However, the Secretariat of Agriculture (SAGARPA), and the Agricultural Commissions from the Congress signed a political agreement, agreeing to make minor modifications to the Law when Congress returned. Under the agreement, minimum changes were established in the conditions of contracts between sugar mills and cane producers where regional differences in the cane production will be considered; government intervention in the business decision making process was curtailed; agreement was reached to cancel a new research center for sugarcane and continue the work in current investigations centers; and the proposed creation of a public parastatal where SAGARPA will have the attributions that were created for this organization was canceled. However, the mill industry continues to argue that the modifications still do not address the competitiveness issue nor how to deal with the complete opening of the sweeteners market scheduled for 2008.

In addition to the new Sugar Law, Mexico has not indicated what path it will take concerning the WTO decision on the tax issue on HFCS. Initially, the 20 percent tax imposed on beverages using high fructose corn syrup (HFCS) dramatically decreased domestic HFCS production, as well as imports. However, due to high domestic sugar prices, the bottling industry decided to seek court injunctions in 2004 to be able to use fructose in soda-drinks. Some companies have won these court injunctions and are taking advantage of the waiver to substitute some HFCS in place of sugar. The tax was imposed as the sugar industry claimed damage to their industry from increased HFCS usage and to have leverage in the U.S. sugar negotiations. However, the tax did not help resolve any of the other issues during U.S.-Mexico sweeteners negotiations and itself became an international issue within the WTO. Mexico will have to decide by December 2005 whether to appeal the WTO decision against the tax, although most industry sources claim that the decision will not impact the sweeteners situation immediately. The sugar industry seems to be in favor of keeping some form of restriction on HFCS, especially since they believe under the current pricing scheme sugar cannot compete against HFCS. In one possible change, some legislators are preparing a proposal for the next Ordinary Session of the Congress in September to change the tax on HFCS use by modifying the allowable percentage of use of sugar and HFCS in beverages. The Federal government, however, has indicated they could select to impose the MFN duty on HFCS imports from the U.S., which is 210 % for HFCS-55, and 156 % for HFCS-42.

Another issue the government faces is the re-privatization of the sugar mills. The government expropriated 27 mills on September 2001, of which four had to be returned by court decisions to their previous owners. In July 2005, SAGARPA announced that the process of selling four sugar mills would be concluded and by the month of August the government could begin with the auction of seven more mills. The best offers for the mills (La Joya in the state of Campeche, Santa Rosalia in the state of Tabasco, and San Pedro and San Francisco in the state of Veracruz) would be made known in July. However, nothing happened at the time, as no investors, domestic or foreign, were interested in buying the mills amid the uncertainty created by the debate of the Sugar Law, leaving the sugar industry without a confident legal framework. It is uncertain when the government will auction the mills again.

SECTION II. STATISTICAL TABLES

CENTRIFUGAL SUGAR TABLE

Mexico						
Sugar, Centrifugal					(1000 MT)	
	2004 Revised		2005 Estimate		2006 Forecast	
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin	10/2003		10/2004		10/2005	
Beginning Stocks	1194	1194	1237	1237	1918	1989
Beet Sugar Production	0	0	0	0	0	0
Cane Sugar Production	5330	5330	6000	6149	5623	6000
TOTAL Sugar Production	5330	5330	6000	6149	5623	6000
Raw Imports	41	41	1	8	1	1
Refined Imp.(Raw Val)	286	286	199	218	100	100
TOTAL Imports	327	327	200	226	101	101
TOTAL SUPPLY	6851	6851	7437	7612	7642	8090
Raw Exports	7	7	9	9	9	9
Refined Exp.(Raw Val)	7	7	3	190	3	150
TOTAL EXPORTS	14	14	12	199	12	159
Human Dom. Consumption	5380	5380	5257	5199	5324	5252
Other Disappearance	220	220	250	225	250	230
Total Disappearance	5600	5600	5507	5424	5574	5482
Ending Stocks	1237	1237	1918	1989	2056	2449
TOTAL DISTRIBUTION	6851	6851	7437	7612	7642	8090

SUGAR CANE FOR CENTRIFUGAL

Mexico						
Sugar Cane for Centrifugal				(1000 HA) (1000 MT)		
	2004 Revised		2005 Estimate		2006 Forecast	
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin	11/2003		11/2004		11/2005	
Area Planted	640	640	640	640	640	640
Area Harvested	609	609	610	612	610	612
Production	45456	45456	48400	50893	48000	49000
TOTAL SUPPLY	45456	45456	48400	50893	48000	49000
Utilization for Sugar	45456	45456	48400	50893	48000	49000
Utilizatn for Alcohol	0	0	0	0	0	0
TOTAL UTILIZATION	45456	45456	48400	50893	48000	49000

SUGAR PRICES

AVERAGE SUGAR PRICES UNITS: 50 KG. BULK/PESOS						
MONTH	STANDARD		CHANGE %	REFINED		CHANGE %
	2004	2005		2004	2005	
January	309.65	322.70	4.21	352.50	340.00	(3.54)
February	296.25	312.00	5.31	340.00	339.50	(0.14)
March	291.25	306.00	5.06	337.20	335.60	(0.47)
April	298.25	306.00	2.59	340.00	339.00	(0.29)
May	297.25	305.25	2.69	337.50	338.80	0.38
June	302.95	304.10	0.37	340.60	335.75	(1.42)
July	317.85	297.25	(6.48)	345.00	335.75	(2.68)
August	326.20	301.50	(7.11)	337.40	333.00	(1.30)
September	331.00	N/A	N/A	339.50	N/A	N/A
October	329.60	N/A	N/A	339.25	N/A	N/A
November	326.05	N/A	N/A	338.20	N/A	N/A
December	329.85	N/A	N/A	341.00	N/A	N/A
CIF Mexico City						

Source: Servicio Nacional de Informacion de Mercados SNIIM-ECONOMIA
http://www.economia-sniim.gob.mx/Sniim-an/e_SelAzu.asp?
2004 Avg. Exchange Rate US$1.00=$11.29 pesos
2005 Avg. Exchange Rate August 24, 2005 US$1.00=$10.77 pesos

Sugar Tariffs

MEXICAN SUGAR IMPORT TARIFFS FOR 2005		
H.T.S. TARIFF # SUBHEADING	NAFTA TARIFFS FOR U.S. COMMODITIES DOLLARS/KG ①	SPECIFIC TARIFF FOR THIRD COUNTRY COMMODITIES DOLLARS/KG
1701.11.01	0.31668	0.338
1701.11.02	0.31668	0.338
1701.11.03	0.31668	0.338
1701.12.01	0.31668	0.36
1701.12.02	0.31668	0.36
1701.12.03	0.31668	0.36
1701.91.01	0.31668	0.36
1701.99.01	0.31668	0.36
1701.99.02	0.31668	0.36
1701.99.99	0.31668	0.36
1806.10.01	0.31668	0.36
2106.90.05	0.31668	0.36

Source: Secretariat of Economy

① Note: The sugar importer must have a written statement from the exporter that certifies that the product has not benefited from the U.S. Sugar Re-export Program. If the importer has this statement, then the sugar will be subject to duty on the second column. Otherwise, the product will be subject to the tariff in column three. The Specific Tariff for third countries in column three, was modified to comply with WTO regulations and announced in the *Diario Oficial* on July 20, 2004. However, on March 2, 2005 SE published new specific tariffs for third countries for the following HTS products: 1701.11.01, 1701.11.02, and 1701.11.03 (see MX5023).